Kawin Industrial Sdn Bhd (in liquidation) v Tay Tiong Soong

HIGH COURT (JOHOR BAHRU) — ORIGINATING SUMMONS NO (MT-1)24–2323 OF 2005
VERNON ONG JC
13 NOVEMBER 2008

Companies and Corporations — Directors — Breach of fiduciary duties — Whether defendant was in breach of his fiduciary duties — Whether defendant as managing director had acted in interest of company — Companies Act 1965 s 132(1)

Companies and Corporations — Directors — Fraud on creditors — Whether defendant as director had participated in carrying on of business with intent to defraud creditors

Companies and Corporations — Winding up — Fraudulent preference — Application for declaration that defendant had committed act of fraudulent preference which was illegal under s 304 of the Companies Act 1965 — Whether business of plaintiff company had been carried out with intent to defraud creditors within meaning of s 304(1)

The plaintiff company had on 12 August 2000 purchased eight units of knitting machinery, accessories and spare parts ('the machinery') from Kawin Knitting Pte Ltd ('Kawin'). During the time of the purchase of the machinery, the plaintiff company had already ceased operations and become an insolvent company. On 19 April 2001 it sold the machinery to Skytex Industries (M) Sdn Bhd ('Skytex') at the price of RM115,500. This sum was paid to the defendant, who was at all material times the managing director of the company. A directors' resolution dated 17 August 2000 confirmed the appointment of the defendant as managing director of the company. In the meantime, the plaintiff's failure to pay the purchase price for the machinery led to judgment being entered for S$210,334.23 against the plaintiff company on 9 April 2002. On 7 August 2003 an order for winding up was made against the plaintiff company and a provisional liquidator was appointed. The provisional liquidator concluded that the plaintiff was insolvent on the basis of the audited accounts of the plaintiff for the financial year ending 31 March 2001. By way of this originating summons the plaintiff had sought, inter alia, a declaration that the payment of RM115,500 made

by Skytex and that was paid to the defendant constituted an act of fraudulent preference in favour of the defendant and was therefore illegal based on the provisions of s 304 of the Companies Act 1965 ('the Act'). The plaintiff's application was supported by the provisional liquidator who had asserted in his affidavit that the sum of RM115,500 when received by the plaintiff from Skytex ought to have been paid into the plaintiff's account instead of being paid to the defendant personally. The provisional liquidator further submitted that the defendant, as managing director of the plaintiff company, had derived an unfair advantage over the other trade creditors, in particular Kawin from whom the plaintiff had purchased the machinery. Based on this the plaintiff submitted that the defendant had demonstrated an intention to defraud within the meaning of s 304 of the Act and the defendant had also acted in breach of his fiduciary duties, imposed by s 132(1) of the Act. The plaintiff company further submitted that the purported ratification by the other directors of the plaintiff could not absolve the defendant from the breach. It was therefore the plaintiff's contention that by making the payment of RM115,500 to himself the defendant had deprived the plaintiff of utilising the said sum to pay off its trade creditors including those who enjoyed priority over the defendant. The defendant admitted being a director of the plaintiff but not its managing director. The defendant's defence was that the payment of RM115,500 did not constitute a fraud within s 304 of the Act because the payment was in settlement of a debt owed by the plaintiff to himself. Relying on the case of *In re Sarflax* [1979] 1 Ch 592 (*Sarflax*'s case) the defendant contended that the plaintiff might discharge its liabilities in any order that it pleased and that when the only allegation was the bare fact of preferring one creditor over another it was impossible to hold that such preference per se constituted fraud. The principal issues to be considered in this case were whether in the circumstances, the business of the plaintiff had been carried out with intent to defraud creditors of the company within the meaning of s 304(1) of the Act and whether the defendant was in breach of the fiduciary duties imposed on him by s 132(1) of the Act.

Held, granting an order in terms of prayers (1), (3) and (5) of the originating summons:

(1) The defendant's contention that he was not a managing director was untrue evidence to the contrary. The board of director's resolution dated 17 August 2000 clearly recorded the appointment of the defendant as managing director of the plaintiff (see para 10).

(2) In the context of the facts of this case s 304(1) provides that if it appears that any business of the company had been carried out with intent to defraud the creditors of the company or for any fraudulent purpose, the court may declare the person knowingly carrying on business of the

plaintiff company to be personally liable for all or any debts of the company as the court directs. On the facts, the purchase of the machinery from Kawin and the subsequent sale of the machinery to Skytex for RM115,500, which was paid personally to the defendant, was clearly carrying on the business of the plaintiff and therefore within the context of s 304(1) of the Act (see paras 13–14).

(3) In the present case by any standard, civil or criminal, there was an intention to defraud Kawin or it was done with a fraudulent purpose. On the facts it was abundantly clear that the plaintiff purchased the machinery when it had already ceased operations and the defendant knew that the plaintiff company being insolvent had no funds to pay the outstanding purchase price to Kawin. Thus, by later selling the machinery and paying the purchase price of RM115,500 to himself it was obvious that the defendant had the intention to fraudulently defraud Kawin, a creditor. Furthermore, the defendant as managing director had acted in a manner which had prejudiced the creditors of the plaintiff company when the company was already insolvent. Such conduct amounted to misfeasance and the defendant may also be sued by the liquidator under s 304(1) for participating in the carrying on of business with intent to defraud creditors. Accordingly, on the facts of this case, a case had been made out under s 304(1) of the Act (see paras 15–16).

(4) *Sarflax*'s case was distinguishable from the present on the fact and was of no aid to the defendant's contention. In the present case there were a series of interconnected transactions, namely the purchase of the machinery when the plaintiff company was insolvent, the non-payment of the purchase price to Kawin, the sale of the machinery to Skytex and the proceeds from that sale being paid to the defendant. The circumstances in which these transactions took place were questionable and showed a clear intention to defraud Kawin (see para 17).

(5) The test as to whether the directors had acted in breach of their fiduciary duties was an objective one and the interest of the company was the most important factor that must be considered when directors exercise their powers. Therefore, under s 132(1) of the Act the directors were in breach of their duty to the company if anyone else's interest was made paramount. On the facts of the present case the payment of the RM115,500 to the defendant himself personally when the plaintiff company had other outstanding debts, including an outstanding judgment entered against the plaintiff by Kawin, could not have been in the interest of the company. The purported ratification by the shareholders of the plaintiff was a mere ploy to deflect the real intention of the whole exercise which was calculated to benefit the defendant personally. In the circumstances this was a clear and obvious case of the

defendant having misapplied the plaintiff's money and not acting honestly in the interests of the plaintiff. Therefore the defendant was liable to replace the misapplied funds (see paras 19–20).

[Bahasa Malaysia summary

Syarikat plaintif telah pada 12 Ogos 2000 membeli lapan unit mesin pengait, aksesori dan alat-alat ganti ('mesin') daripada Kawin Knitting Pte Ltd ('Kawin'). Semasa pembelian mesin tersebut, syarikat plaintif telah berhenti beroperasi dan menjadi syarikat yang tak solven. Pada 19 April 2001, mesin tersebut telah dijual kepada Skytex Industries (M) Sdn Bhd ('Skytex') pada harga RM115,500. Jumlah ini telah dibayar kepada defendan, yang mana pada masa yang material adalah pengarah urusan syarikat. Resolusi pengarah yang bertarikh 17 Ogos 2000 mengesahkan pelantikan defendan sebagai pengarah urusan syarikat. Sementara itu, kegagalan plaintif untuk membayar harga belian untuk mesin tersebut telah menyebabkan penghakiman telah dimasukkan untuk sejumlah S$210,334.23 terhadap syarikat plaintif pada 9 April 2002. Pada 7 Ogos 2003 satu perintah penggulungan telah dibuat terhadap syarikat plaintif dan penyelesai sementara telah dilantik. Penyelesai sementara telah membuat kesimpulan bahawa plaintif adalah tak solven atas dasar akaun plaintif yang diaudit untuk tahun kewangan yang berakhir pada 31 Mac 2001. Melalui saman pemula ini plaintif memohon, antara lain, satu deklarasi bahawa pembayaran RM115,500 yang telah dibuat oleh Skytex dan yang telah dibayar kepada defendan membentuk penipuan yang lebih mengutamakan pihak defendan dan oleh itu adalah dilarang berdasarkan kepada peruntukan s 304 Akta Syarikat 1965 ('Akta'). Permohonan plaintif disokong oleh penyelesai sementara yang telah menyatakannya dalam afidavitnya bahawa sejumlah RM115,500 apabila diterima oleh plaintif daripada Skytex seharusnya dibayar ke dalam akaun plaintif namun sebaliknya telah dibayar kepada defendan sendiri. Penyelesai sementara selanjutnya menghujahkan bahawa defendan, sebagai pengarah urusan syarikat plaintif, telah mendapat faedah yang tidak adil terhadap pemberi kredit perdagangan yang lain, terutama Kawin dari mana plaintif telah membeli mesin tersebut. Berdasarkan perkara ini, plaintif menghujahkan bahawa defendan telah menunjukkan niat untuk menipu di dalam pentafsiran s 304 Akta dan defendan juga telah bertindak melanggar tanggungjawab fidusiarinya, yang ditetapkan oleh s 132(1) Akta. Syarikat plaintif selanjutnya menghujahkan bahawa tujuan ratifikasi oleh pengarah-pengarah plaintif yang lain tidak boleh melepaskan defendan daripada perlanggaran tersebut. Oleh itu, penegasan plaintif bahawa dengan membuat pembayaran sejumlah RM115,500 kepada dirinya, defendan telah menghalang plaintif menggunakan jumlah tersebut untuk membayar pemberi kredit perdagangannya termasuk mereka yang menikmati keutamaan terhadap defendan. Defendan mengaku pengarah plaintif tetapi

A bukannya pengarah urusan. Pembelaan defendan adalah pembayaran RM115,500 tidak membentuk fraud menurut s 304 Akta kerana pembayaran tersebut adalah sebagai penyelesaian hutang plaintif kepadanya. Berdasarkan kes *In re Sarflax* [1979] 1 Ch 592 ('*Sarflax*') defendan menegaskan bahawa plaintif boleh melepaskan liabilitinya dalam apa jua cara B yang disenanginya dan apabila satu-satunya dakwaan adalah fakta kosong yang mengutamakan satu pemiutang ke atas yang lain, adalah mustahil untuk memutuskan bahawa keutamaan sahaja membentuk fraud. Isu utama untuk dipertimbangkan dalam kes ini adalah sama ada dalam keadaan tersebut, perniagaan plaintif telah dijalankan dengan tujuan untuk menipu C pemiutang-pemiutang syarikat dalam maksud s 304(1) Akta dan sama ada defendan telah melanggar tanggungjawab fidusiari yang dipertanggungjawabkan ke atasnya oleh s 132(1) Akta.

D **Diputuskan**, membenarkan perintah seperti yang dipohon di perenggan (1), (3) dan (5) saman pemula:

(1) Penegasan defendan bahawa defendan bukan seorang pengarah urusan adalah tidak benar berdasarkan keterangan yang bertentangan. Resolusi E lembaga pengarah yang bertarikh 17 Ogos 2000 jelas merekodkan perlantikan defendan sebagai pengarah urusan plaintif (lihat perenggan 10).

(2) Dalam konteks fakta kes ini s 304 memperuntukkan jika ianya F kelihatan bahawa mana-mana perniagaan syarikat yang dijalankan dengan tujuan untuk menipu pemiutang-pemiutang syarikat atau untuk apa juga tujuan penipuan, mahkamah boleh mengisytiharkan orang yang dengan sengaja menjalankan perniagaan syarikat plaintif untuk bertanggungjawab secara peribadi untuk semuanya atau G mana-mana hutang syarikat seperti yang diarahkan mahkamah. Berdasarkan fakta, pembelian mesin daripada Kawin dan kemudiannya menjual mesin tersebut kepada Skytex untuk RM115,500, yang mana telah dibayar secara peribadi kepada defendan, adalah jelas menjalankan perniagaan plaintif dan oleh itu adalah dalam konteks s 304(1) Akta H (lihat perenggan 13–14).

(3) Dalam kes ini berdasarkan mana-mana standard, sivil atau jenayah, terdapat niat untuk menipu Kawin atau ianya telah dilakukan dengan tujuan untuk menipu. Berdasarkan fakta ianya adalah jelas bahawa plaintif telah membeli mesin tersebut apabila plaintif telah pun I berhenti beroperasi dan defendan mengetahui bahawa syarikat plaintif yang tak solven tidak mempunyai dana untuk membayar harga belian yang tertunggak kepada Kawin. Oleh itu, dengan kemudiannya menjual mesin tersebut dan membayar harga belian sejumlah RM115,500 kepadanya adalah jelas bahawa defendan mempunyai niat

untuk menipu Kawin, pemiutang. Tambahan pula, defendan sebagai pengarah urusan telah bertindak seperti memprejudiskan pemiutang-pemiutang syarikat plaintif sedangkan syarikat telah pun tak solven. Tindakan tersebut menjadi misfeasans dan defendan boleh juga didakwa oleh penyelesai di bawah s 304(1) bagi terlibat di dalam menjalankan perniagaan dengan tujuan untuk menipu pemiutang-pemiutang. Sewajarnya, berdasarkan fakta kes ini, satu kes telah terbentuk di bawah s 304(1) Akta (lihat perenggan 15–16).

(4) Kes *Sarflax* adalah berbeza dengan kes ini atas fakta dan tidak membantu penegasan defendan. Dalam kes ini terdapat siri transaksi yang berkait, iaitu, pembelian mesin apabila syarikat plaintif tak solven, harga belian yang tidak dibayar kepada Kawin, penjualan mesin kepada Skytex dan hasil daripada jualan yang dibayar kepada defendan. Keadaan di mana transaksi-transaksi ini berlaku adalah dipersoalkan dan menunjukkan tujuan yang jelas untuk menipu Kawin (lihat perenggan 17).

(5) Ujian sama ada pengarah-pengarah telah bertindak melanggar tanggungjawab fidusiarinya adalah satu yang objektif dan kepentingan syarikat adalah faktor paling penting yang perlu dipertimbangkan apabila pengarah melaksanakan kuasa mereka. Oleh itu, di bawah s 132(1) Akta, pengarah-pengarah adalah melanggari tanggungjawab mereka kepada syarikat jika kepentingan seseorang yang lain dijadikan keutamaan. Berdasarkan kepada fakta kes ini, pembayaran RM115,500 kepada defendan sendiri apabila syarikat plaintif mempunyai hutang tertunggak yang lain, termasuk penghakiman yang dimasukkan terhadap plaintif oleh Kawin, tidak boleh menjadi kepentingan syarikat. Tujuan ratifikasi oleh pemegang-pemegang saham plaintif hanyalah helah untuk memesongkan tujuan sebenar keseluruhan tugasan yang telah mengambilkira kepada faedah defendan sendiri. Dalam keadaan tersebut, ini merupakan kes yang nyata dan jelas yang mana defendan telah menyalahgunakan wang plaintif dan tidak bertindak jujur demi kepentingan plaintif. Oleh itu defendan adalah bertanggungjawab untuk menggantikan dana yang disalahgunakan (lihat perenggan 19–20).]

Notes

For cases on breach of fiduciary duties, see 3(1) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 197–203.

For cases on directors in general, see 3(1) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 153–355.

For cases on fraudulent preference, see 3(1) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 1070–1080.

Cases referred to

Augustus Barnett & Son Ltd, Re [1986] BCLC 170 (refd)
Charterbridge Corp Ltd v Lloyds Bank Ltd & Anor [1970] Ch 62, Ch D (refd)
Coleman v The Queen (1987) 5 ACLC 766, SC (refd)
Company, In a (No 01418 of 1988) [1991] BCLC 198 (refd)
FP & CH Matthews Ltd, In re [1982] 1 All ER 338, CA (refd)
Gerald Cooper Chemicals Ltd, In re [1978] 2 All ER 49, Ch D (refd)
Kinsela v Russell Kinsela Pte Ltd (1986) 4 ACLC 215 (refd)
Marchesi v Barnes & Keogh [1970] VR 434 (refd)
Patrick & Lyon Ltd, In re [1933] Ch 786 (refd)
Pharmamalaya Bhd (in receivership) v Dinesh Kumar a/l Jashbhai Nagjibha Patel & Ors [2004] 6 AMR 661 (refd)
R v Grantham [1984] 3 All ER 166, CA (refd)
Sarflax Ltd, Re [1979] 1 Ch 592; [1979] 2 WLR 202, Ch D (distd)
Siow Yoon Keong v H Rosen Engineering BV [2003] 4 MLJ 569; [2003] 5 AMR 735, CA (refd)
Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & Ors and other appeals [1996] 2 MLJ 265, CA (refd)
William C Leitch Bros Ltd, In re [1932] 2 Ch 71, Ch D (refd)
Winkworth v Edward Baron Development Co Ltd & Ors [1987] 1 All ER 114, HL (refd)

Legislation referred to

Companies Act 1965 ss 132, 132(1), 132(3), 304, 304(1), 305, 305(1)

Hezeyana bt Hamdani (Hazelin & Associates) for the plaintiff.
Manian K Marappan (Manian K Marappan & Co) for the defendant.

Vernon Ong JC:

[1] This originating summons (encl 3) by the plaintiff is for, inter alia, a declaration that the payment of RM115,500 made on or about 19 April 2001 by Skytex Industries (M) Sdn Bhd ('Skytex') to the defendant obtained from the proceeds of sale of eight units of knitting machineries, accessories and spare parts belonging to the plaintiff (in liquidation) to Skytex constitutes an act of fraudulent preference in favour of the defendant and is therefore illegal based on the provisions of s 304 of the Companies Act 1965 ('the Act').

[2] The plaintiff's application is supported by the affidavit affirmed on 27 July 2005 (encl 4) by V Ventkatachalam the provisional liquidator of the plaintiff ('the plaintiff's affidavit'). In resisting the plaintiff's application the defendant filed an affidavit in reply affirmed on 28 January 2008 (encl 29) ('the defendant's affidavit').

BRIEF ACCOUNT OF THE FACTS

[3] On 7 August 2003 an order for the winding up of the plaintiff company was made by the Johor Bahru High Court and V Ventkatachalam ('the provisional liquidator') was appointed as provisional liquidator of the plaintiff. The defendant was at all material times the managing director of the plaintiff. The provisional liquidator concluded that the plaintiff was insolvent on the basis of the audited accounts of the plaintiff for the financial year ending 31 March 2001. There was also an outstanding judgment entered against the plaintiff for S$210,334.23 at the Johor Bahru High Court on 9 April 2002 by Kawin Knitting (Pte) Ltd. The said judgment is in respect of the unpaid purchase price of eight units of used knitting machinery, accessories and spare parts ('the machineries') purchased on 12 August 2000. Pursuant to an agreement for sale of machineries dated 19 April 2001 the plaintiff sold the machineries to Skytex at the purchase price of RM115,500. The purchase price of RM115,500 was paid to the defendant.

THE PLAINTIFF'S SUBMISSION

[4] Learned counsel for the plaintiff submitted that the payment of RM115,500 to the defendant is illegal and in contravention of ss 304, 305 and 132 of the Companies Act 1965 ('the Act'). Accordingly, the defendant is under a duty to repay the said sum to the plaintiff. The defendant has admitted to receiving the said sum but contends that it was made to satisfy a debt owed by the plaintiff to him. The defendant admits that he is a director of the plaintiff but denies being a managing director.

[5] Learned counsel submitted that the transaction for the sale of the machineries to Skytex was carried out with the intent to defraud the other creditors of the plaintiff and or the defendant had misapplied the money or property of the plaintiff in breach of his duties in relation to the plaintiff. Under the circumstances the court is empowered to order the defendant to repay the said sum of RM115,500 to the plaintiff under ss 304 and 305(1) which provide as follows:

> 304 Responsibility for fraudulent trading
>
> (1) If in the course of the winding up of a company or in any proceedings against a company it appears that any business of the company has been carried out with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company may if it thinks proper so to do declare that any person who was knowingly a party to the carrying on the business in that manner shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court directs.

305 Power of Court to assess damages against delinquent officers, etc.

(1) If in the course of winding up it appears that any person who has taken part in the formation or promotion of the company or any past or present liquidator or officer has misapplied or retained or become liable or accountable for any money or property of the company or been guilty of any misfeasance or breach of trust or duty in relation to the company, the Court may on the application of the liquidator or of any creditor or contributory examine into the conduct of that person liquidator or officer and compel him to repay or restore the money or property or any part thereof with interest at such rate as the Court thinks fit, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication retainer misfeasance or breach of trust or duty as the Court thinks fit.

[6] The provisional liquidator asserts that the defendant knew that the purchase price of the machineries has not been paid for by the plaintiff. The defendant also knew that at the material time the plaintiff was insolvent. The defendant has also admitted to the fact that the judgment against the plaintiff remains unsatisfied. The said sum of RM115,500 when received by the plaintiff from Skytex should have been paid into the plaintiff's account. Instead the defendant caused the said sum to be paid to him personally. In so doing the defendant as a managing director of the plaintiff derived for himself an unfair advantage over that of other trade creditors, in particular Kawin Knitting (Pte) Ltd from whom the plaintiff purchased the machineries. In the premises the defendant had clearly demonstrated an intention to defraud within the meaning of s 304 (*Siow Yoon Keong v H Rosen Engineering BV* [2003] 4 MLJ 569; [2003] 5 AMR 735; *Winkworth v Edward Baron Development Co Ltd & Ors* [1987] 1 All ER 114 (HL)). Learned counsel also submitted the ratification by the shareholders of the plaintiff of the defendant's act is ineffective as the defendant's act was done for a fraudulent purpose (*Director & Civil Breach of Trust* by Hamid Ibrahim, Gavel Publication (M) 2006 at p 98; *Company Law* by Walter Woon, Thomson Sweet & Maxwell (3rd Ed)).

[7] It was also submitted that the defendant had also acted in breach of his fiduciary duties imposed by s 132(1) of the Act which provides that: 'A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.' The test whether the directors have acted in breach of their fiduciary duties is an objective one (*Charterbridge Corp Ltd v Lloyds Bank Ltd & Anor* [1970] Ch 62 at p 72; *Pharmamalaya Bhd (in receivership) v Dinesh Kumar a/l Jashbhai Nagjibha Patel & Ors* [2004] 6 AMR 661). By making the payment of RM115,500 to himself the defendant has clearly compromised the financial position of the plaintiff. It has deprived the plaintiff of utilising the said sum to pay off its trade creditors including those which enjoyed priority over the defendant. The defendant's conduct

cannot be therefore said to have been carried out in a bona fide manner or to have been taken in the interest of the plaintiff.

[8] It was further submitted that the purported ratification by the other directors of the plaintiff cannot absolve the defendant from the breach (*Principles of Company Law in Malaysia* by Shanty Rachagan, Janine Pascoe and Anil Joshi, MLJ KL 2002 at p 421; *Kinsela v Russell Kinsela Pte Ltd* (1986) 4 ACLC 215).

THE DEFENDANT'S SUBMISSION

[9] Learned counsel for the defendant short submission is grounded on one issue only, namely: that the payment of RM115,500 preferring the defendant does not constitute a fraud within the meaning of s 304(1) (citing *In re Sarflax Ltd* [1979] 1 Ch 592).

FINDING OF THE COURT

[10] The defendant admitted that he was a director of the plaintiff but denied being a managing director. However, according to the board of directors' resolution dated 17 August 2000 exhibited in the plaintiff's affidavit (para 14) the appointment of the defendant as managing director of the plaintiff is clearly recorded. Paragraph 14 of the plaintiff's affidavit is admitted by the defendant. In the circumstances, the defendant's contention that he is not a managing director is untrue. The defendant has also admitted to having knowledge of the outstanding judgment against the plaintiff. The payment of RM115,500 which is due to the plaintiff but was instead paid to the defendant is also admitted by the defendant. The defendant's justification is that the payment was in settlement of a debt owed by the plaintiff to himself.

[11] In this case there are two principal issues to be determined: (i) whether in the circumstances, the business of the plaintiff has been carried out with intent to defraud creditors of the company within the meaning of s 304(1); and (ii) whether the defendant is in breach of his fiduciary duties imposed by s 132(1).

Issue (i)

[12] The issue before the court falls upon the interpretation of s 304(1) and whether the facts of this case fall within the meaning of that subsection. The wording of the section is very clear. It is not necessary in order to establish fraud that the creditors were in fact defrauded. An intention to defraud is sufficient. In this respect, an intent to defraud is an intent to deprive

creditors, or some creditors, of an economic advantage or inflict upon them some economic loss (see *Coleman v The Queen* (1987) 5 ACLC 766).

[13] In the context of the facts of this case s 304(1) provides that if it appears that any business of the company has been carried out with intent to defraud the creditors of the company or for any fraudulent purpose, the court may on application of the liquidator declare that a person who was knowingly a party to the carrying of the business in that manner shall be personally responsible for all or any of the debts of the company as the court directs. Essentially, it is a matter of making a finding of facts. According to the facts as disclosed by the affidavit evidence the following material facts have been admitted by the defendant.

[14] In the circumstances aforesaid can it be said that any business of the plaintiff company has been carried out within the context of s 304(1)? The phrase 'any business of the company has been carried out ...' has been interpreted in a number of cases to include (i) in a criminal case, the obtaining credit for the company (see *R v Grantham* [1984] 3 All ER 166); (ii) providing letters of comfort to a subsidiary even though on the facts of that case was held not to be fraudulent (see *Re Augustus Barnett & Son Ltd* [1986] BCLC 170); (iii) the collection of assets acquired in the course of business and the distribution of proceeds thereof in payment of debts (see *In re Sarflax Ltd* [1979] 2 WLR 202); and (iv) payment of two cheques into the company current account with the bank thereby clearing the company's overdraft (see *In re FP & CH Matthews Ltd* [1982] 1 All ER 338). On the facts of this case the purchase of the machineries from Kawin Knitting (Pte) Ltd, the subsequent sale of the machineries to Skytex and the payment of the sum of RM115,500 to the defendant was clearly carrying on the business of the plaintiff.

[15] Was the business of the plaintiff carried out 'with intent to defraud creditors ... or for any fraudulent purpose' within the context of 304(1)? This phrase has also been interpreted in a number of cases to include (i) a situation where a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts (see *In re William C Leitch Bros Ltd* [1932] 2 Ch 71); (ii) that fraud in the context of fradulent trading connotes 'actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame' (see *In re Patrick & Lyon Ltd* [1933] Ch 786 at p 790); (iii) where a person who takes part in the management of a company's affairs obtains credit or further credit for the company when he knows that there is no reason for thinking that funds will become available to pay the debts when it becomes due or shortly thereafter (see *R v Grantham*; (iv) where a company accepted the purchase price in

advance knowing that it could not supply the goods and would not repay the advance paid (see *In re Gerald Cooper Chemicals Ltd* [1978] 2 All ER 49) and (v) a person was knowingly party to the business of a company having been carried out with intent to defraud creditors if at the time when debts were incurred by the company he had no good reason for thinking that funds would be available to pay those debts when they became due or shortly thereafter and there was dishonesty involving real moral blame according to current notions of fair trading (see *In a Company (No 01418 of 1988)* [1991] BCLC 198). In the present case by any standard, civil or criminal, there was an intention to defraud Kawin Knitting (Pte) Ltd or it was done with fraudulent purpose. The term 'if it appears' in s 304(1) only requires a lower degree of proof. Be that as it may, on the facts it is abundantly clear that there was intent to defraud. The purchase of the machineries was done when the plaintiff had already ceased operations. It must have been within the defendant's knowledge that the plaintiff company being insolvent had no funds to pay the purchase price to Kawin Knitting (Pte) Ltd. By paying the RM115,500 to himself the plaintiff was left with no funds to pay the outstanding purchase price to Kawin Knitting (Pte) Ltd. The so-called authorisation by the shareholders of the plaintiff is of no avail to the defendant. It is obvious that the intention was to defraud Kawin Knitting (Pte) Ltd a creditor. It is also equally obvious that all this was done fraudulently.

[16] A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors (see *Winkworth*). In this case the purported ratification by the shareholders of the payment to the defendant is ineffective as the plaintiff company was at the material time insolvent (see *Directors and Civil Breach of Trust* by Hamid Ibrahim 2006 at p 98). The defendant as managing director has acted in a manner which has prejudiced the creditors of the plaintiff company when the plaintiff company was already insolvent. Such conduct amounts to misfeasance and the defendant may also be sued by the liquidator under s 304(1) for participating in the carrying on of a business with intent to defraud creditors (see *Company Law* by Walter Woon (3rd Ed) at p 286). Accordingly, on the facts the court finds that a case has been made out under s 304(1).

[17] Learned counsel for the defendant relying on *In re Sarflax Ltd*, contended that the plaintiff might discharge its liabilities in any order that it pleases and that when the only allegation was the bare fact of preferring one creditor over another it was impossible to hold that such preference per se constituted fraud. *In re Sarflax Ltd*, is distinguishable on the facts. In that case

A the only allegation was the bare fact of preferring one creditor over another. In the present case, there was a series of interconnected transactions, namely, the purchase of the machineries when the plaintiff was already an insolvent company, the non-payment of the purchase price to Kawin Knitting (Pte) Ltd, the sale of the machineries to Skytex and the payment of the B RM115,500 to the defendant. The circumstances in which all these transactions took place were questionable and not entirely straight forward. There is clear evidence of intent to defraud Kawin Knitting (Pte) Ltd (see *Siow Yoon Keong* (CA)). Accordingly, *In re Sarflax Ltd*, is of no aid to the defendant's contention.

C

Issue (ii)

[18] A director of a company is duty bound to act honestly and use D reasonable diligence in the discharge of the duties of the office (s 132(1)). The duty imposed is fiduciary in nature. (see *Tengku Abdullah ibni Sultan Abu Bakar & Ors v Mohd Latiff bin Shah Mohd & Ors and other appeals* [1996] 2 MLJ 265 (CA)). The test whether the directors have acted in breach of their fiduciary duties is an objective one, in that, in the absence of separate E consideration: 'Whether an honest and intelligent man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company' (see Chan & Koh on *Malaysian Company Law, Principles and Practice* (2nd Ed) at p 589 referring to the test laid down by F Pennycuick J in *Chaterbridge Corp Ltd*).

[19] The phrase 'act honestly' in s 132(1) has been defined in *Marchesi v Barnes & Keogh* [1970] VR 434 as 'To 'act honestly' refers to acting bona fide in the interests of the company in the performance of the functions attaching G to the office of director'. In this respect the directors must exercise their discretion bona fide in what they consider is in the interests of the company. It is therefore clear that the interest of the company is the most important factor that must be considered when directors exercise their powers. The directors are in breach of their duty to the company if anyone else's interest H is made paramount.

[20] In the light of the fact that at the material time the plaintiff had ceased operations and was insolvent, the timing of the purchase of the machineries, the non-payment of the purchase price to Kawin Knitting (Pte) Ltd, the sale I of the machineries to Skytex and the payment of the RM115,500 to himself personally could not be said by any stretch of imagination to have been in the interest of the plaintiff. The purported ratification by the shareholders of the plaintiff was a mere ploy to deflect the real intention of the whole exercise which is calculated to benefit the defendant personally. This is a clear and

obvious case of the defendant and managing director having misapplied the plaintiff's money and therefore the defendant is liable to replace them (s 132(3)). In the circumstances the defendant could not be said to have acted honestly in the interests of the plaintiff.

[21] For the reasons adumbrated the court granted an order in terms of prayers (1), (3) and (5) of the originating summons in encl 3.

Prayers (1), (3) and (5) of the originating summons granted.

Reported by K Nesan